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MEMORANDUM

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TO: Docket Control

2002 OCT 16 P 1:26

FROM: Ernest G. Johnson
for Director
Utilities Division

AZ CORP COMMISSION
DOCUMENT CONTROL

DATE: October 16, 2002

RE: STAFF REPORT FOR POTATO PATCH WATER SERVICE, INC. SALE OF ASSETS TO POTATO PATCH OWNERS ASSOCIATION, AN ARIZONA NON-PROFIT CORPORATION, D.B.A. POTATO PATCH COMMUNITY WATER UTILITY, AND APPLICATION FOR ADJUDICATION NOT A PUBLIC SERVICE CORPORATION BY POTATO PATCH OWNERS ASSOCIATION (DOCKET NOS. W-01936A-02-0677 AND WS-04096A-02-0233)

Attached is the Staff Report for Potato Patch Owners Association, an Arizona Non-Profit Corporation D.B.A. Potato Patch Community Water Utility, and application for approval of a transfer of assets from Potato Patch Water Services, Inc. and request for adjudication not a public service corporation. Staff recommends the Commission approve the transfer of assets from Potato Patch Water Service, Inc., to Potato Patch Owners Association, and approval of Potato Patch Owners Association application for adjudication not a public service company.

EGJ:JEF:nms

Originator: Jim Fisher

Attachment: Original and Sixteen Copies

Arizona Corporation Commission

DOCKETED

OCT 16 2002

DOCKETED BY	<i>CAZ</i>
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Service List for Potato Patch Water Service, Inc., and
Potato Patch Owners Association, D.B.A.
Potato Patch Community Water Utility
Docket Nos. W-01936A-02-0677 and WS-04096-02-0233

Ms. Susan Corey
System Coordinator
7336 South Heather Drive
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Mr. Robert Hannay
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15 Highland Terrace
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Mr. Christopher C. Kempley
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Ms. Lyn Farmer
Chief, Hearing Division
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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**POTATO PATCH WATER SERVICE, INC., AND
POTATO PATCH OWNERS ASSOCIATION,
D.B.A. POTATO PATCH COMMUNITY WATER UTILITY**

**DOCKET NOS.
W-01936A-02-0677
AND
WS-04096A-02-0233**

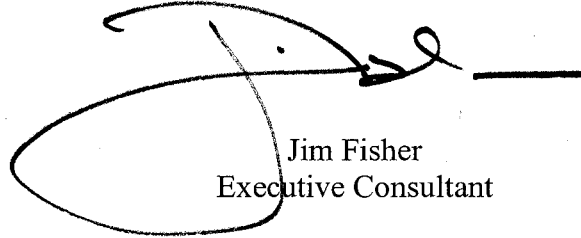
**APPLICATION FOR APPROVAL OF SALE
OF ASSETS, AND CANCELATION OF THE
CERTIFICATE OF CONVIENANCE AND NECESSITY**

**APPLICATION FOR ADJUDICATION
NOT A PUBLIC SERVICE CORPORATION**

OCTOBER 2002

STAFF ACKNOWLEDGMENT

The Staff Report for Potato Patch Owners Association, an Arizona Non-Profit Corporation, D.B.A. Potato Patch Community Water Utility (Docket Nos.W-01936A-02-0677 and WS-04096A-02-0233) was the responsibility of Jim Fisher. Jim Fisher was responsible for the review and analyses of the Companies applications.

A handwritten signature in black ink, consisting of a large, stylized 'J' followed by a horizontal line and a small flourish.

Jim Fisher
Executive Consultant

**EXECUTIVE SUMMARY OF
POTATO PATCH WATER SERVICE, INC. AND
POTATO PATCH OWNERS ASSOCIATION,
D.B.A. POTATO PATCH COMMUNITY WATER UTILITY
DOCKET NOS. W-01936A-02-0677 AND WS-04096A-02-0233**

On March 25, 2002, Potato Patch Owners Association, ("Owners Association") an Arizona Non-Profit Corporation, D.B.A. Potato Patch Community Water Utility ("Water Utility") filed an Application for an Adjudication Not a Public Service Corporation with the Arizona Corporation Commission ("ACC" or "Commission"). On September 9, 2002, Potato Patch Water Services, Inc. filed an application for approval for the sale of assets and transfer of the Certificate of Convenience and Necessity.

The Owners Association is composed of the residents and lot owners within Potato Patch. The metered customers of the Owners Association combined financial resources and purchased the assets of Potato Patch Water Service, Inc., in February 2002. By this Application the Owners Association is requesting approval of the asset transfer and a determination that the Owners Association is not a public service corporation for purposes of utility regulation by the ACC.

The criteria to determine that a provider is not a public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution was reviewed by the Arizona Supreme Court in Natural Gas Service Company v. Serv-U Cooperative, Inc. The Court provided eight review criteria for the Commission to review. The Commission issued a policy directive for the evaluation of applications for adjudication not a public service corporation on May 7, 1987, in Decision No. 55568 that included seven criteria. The Utilities Division was directed to ensure that all such applications complied with seven criteria. Staff has found the application has met the requirements for adjudication as outlined by ACC Decision No. 55568.

Potato Patch Owners Association, D.B.A. Potato Patch Community Water Utility has properly filed for, and met the ACC's criteria for adjudication not a public service company. The Owners Association is a non-profit association, whose customers are its members. All members have equal voting rights. No municipal or private utility is seeking to serve the area, and the association will not be in competition with any provider.

While this application represents the request of 90 current members, it is for part time customers. The community is recreational in nature, primarily summer cabins, requiring seasonal services. The ACC has granted other adjudication applications of as many as 90 and 132 members. Therefore, it would be consistent with existing public policy to grant the requested adjudication.

Staff recommends that the Commission approve the transfer of assets from Potato Patch Water Service, Inc. to Potato Patch Owners Association. Staff further recommends that the Commission grant the Potato Patch Owners Association, D.B.A. Potato Patch Community Water Utility request for adjudication not a public service corporation.

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Introduction

On March 25, 2002, Potato Patch Owners Association, ("Owners Association") an Arizona Non-Profit Corporation, D.B.A. Potato Patch Community Water Utility ("Water Utility") filed an Application for an Adjudication Not a Public Service Corporation with the Arizona Corporation Commission ("ACC" or "Commission"). On September 9, 2002, Potato Patch Water Services, Inc. filed an application for approval for the sale of assets and transfer of the Certificate of Convenience and Necessity ("CC&N").

The Owners Association is composed of the residents and lot owners of Potato Patch. Potato Patch consists of 133 lots, of those lots, 90 are currently metered for water service from Potato Patch Water Service, Inc., the currently certificated water provider. The metered customers of the Owners Association combined financial resources and purchased the assets of Potato Patch Water Service, Inc. in February 2002. By this Application the Owners Association is requesting approval of the asset transfer and a determination that Water Utility is not a public service corporation for purposes of utility regulation by the ACC.

Background

The community of Potato Patch is primarily a vacation retreat located east of Prescott, near Lynx Lake. Potato Patch Water Service, Inc. and its predecessor has provided regulated water services to the community since 1964. The system has suffered from numerous problems including leaking and frozen pipes. Customers made numerous repairs to the system to ensure proper service.

The Owners Association purchased the water production and distribution system of Potato Patch Water Service, Inc. in February 2002, and currently provides water service to all of its members. The system includes one existing well, one well in development, two pumps, pump controls, hydro pneumatic tank, and pump houses. The system also has one 60,000 gallon storage tank and 9,180 feet of distribution piping consisting of 4 inch to 1 inch. Currently 90 meters are connected to the system.

The Owners Association purchased the system for \$105,000. The Owners Association obtained funding to purchase the utility assets through the individual contributions from 88 of 90 metered customers. Each metered customer contributed \$1,675 for the purchase and upgrade of the utility assets of Potato Patch Water Service, Inc. In addition, the Ownership Association has arranged a \$150,000 line of credit through Wells Fargo Bank to be used for system maintenance, upgrades or repairs.

The Owners Association has ensured that water quality tests have also been regularly performed and submitted to the Arizona Department of Environmental Quality ("ADEQ") for compliance with drinking water testing requirements. On August 26, 2002, Staff received a Compliance Status Report from ADEQ for the Potato Patch system. The report demonstrates that ADEQ has determined that the system is currently delivering water that meets the water quality standards required by the Arizona Administrative Code, Title 18, Chapter 4.

Initially, the Owners Association obtained community support for the formation of an Improvement District. The Owners Association made an application with Yavapai County, and received approval from the Board of Supervisors to form an Improvement District to govern the distribution of domestic water service in Potato Patch. Subsequently, the Owners Association determined the "administrative cost factors were excessive and very inflexible" and as such the Improvement District was "an inappropriate structure" for the community. The Owners Association then determined requesting adjudication not a public service company from the ACC was the appropriate process to meet the needs of the community.

Transfer of the Utility Assets

The service area sought for adjudication by the Owners Association is currently certificated to Potato Patch Water Services, Inc. Potato Patch Water Service, Inc., is an Arizona subchapter "S" corporation which received a CC&N for portions of Yavapai County in Decision No. 35237 (May 28, 1964). A review of its last annual report shows that the company's annual revenue was reported as approximately \$21,000, with expenses of \$24,000. The company's last rate case, (Decision No. 58582, April 6, 1994) authorized a monthly charge of \$22.50, inclusive of 1,000 gallons of usage, and \$3.00 per additional 1,000 gallon increments.

Potato Patch Water Services, Inc. has filed an application requesting approval of the transfer of assets to the Owners Association. Potato Patch Water Services, Inc. has provided a copy of the sale agreement, amendments and warranty deed. According to the transfer application all security deposits have been refunded, and no refunds on main extension agreements are due. The Owners Association has assumed the obligation for refunds on meters and service lines.

The Owners Association raised funds from its members to obtain and improve the water distribution assets, as well as arranging for a line of credit from Wells Fargo. A certified operator is retained to manage the water system. Regular water quality testing is performed and submitted to the ADEQ. ADEQ reports the system is providing water that meets ADEQ requirements. In addition, the Owners Association communicates with all members regarding water availability, the need to conserve and ongoing system repairs.

The current CC&N holder and management contact resides in Paradise Valley. The Owners Association however, are owners and customers, within the community. In the company's last rate case the Commission recognized the distribution system was not properly installed, subjecting it to freezing, breakage and costly repair. The Owners Association has demonstrated a unified and significant interest in ensuring the water distribution system is repaired, properly maintained and operated

The Owners Association has demonstrated that they are a fit and proper entity to operate water distribution assets to serve the community of Potato Patch. The system has undergone numerous repairs, is operated by a certified operator, is within ADEQ requirements and is being upgraded to enhance water production. Staff recommends that the Commission approve the sale of assets of Potato Patch Water Service, Inc. to the Potato Patch Owners Association.

Request for Adjudication

The Ownership Association filed to be adjudicated not a public service company by the ACC for purposes of utility regulation in Arizona. The criteria to determine that a provider is not a public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution was reviewed by the Arizona Supreme Court in Natural Gas Service Company v. Serv-U Cooperative, Inc. The Court provided eight review criteria for the Commission to review.

1. What the corporation actually does.
2. Whether the service is dedicated to a public use.
3. That the Articles of Incorporation evidence authorization and purposes.
4. Whether the corporation is dealing with the service of a commodity in which the public has been generally held to have an interest.
5. Whether the corporation is monopolizing or intending to monopolize a territory with a public service commodity.
6. Whether the corporation is accepting of substantially all requests for service.
7. That service is under contract and reserving the right to discriminate is not always controlling.
8. Whether the corporation will have actual or potential competition with other corporations whose business is clothed with the public interest.

The Commission issued a policy directive for the evaluation of applications for adjudication not a public service corporation on May 7, 1987, in Decision No. 55568. The Utilities Division was directed to ensure that all such applications complied with the following seven criteria.

1. Adjudication applications must be submitted by a non-profit homeowners association.

2. The application for adjudication not a public service corporation is a bona fide request by a majority of the membership of the association through a petition signed by 51 percent or more of the then existing members.
3. That all such associations making such application have complete ownership of the system and necessary assets.
4. That every customer is a member/owner with equal voting rights and that each member is or will be a customer.
5. That the service area involved encompasses a fixed territory, which is not within the service area of a municipal utility or public service corporation; or if in such territory, that municipal utility or public service corporation is unable to serve.
6. That there is a prohibition against further sub-division evidenced by deed restrictions, zoning, water restrictions or other enforceable governmental regulations.
7. That the membership is restricted to a fixed number of customers actual or potential.

The Commission has long recognized that the public interest is served when a public service company's assets and CC&N are transferred to other ownership which ensures the current customers will receive service that is equal to or better than the current provider. The Potato Patch Owners Association, a non-profit community association, submitted the application for Potato Patch Water Utility. The members of Potato Patch comprise the current membership of Potato Patch. The Owners Association submitted a resolution authorizing this application for adjudication approved by 79 percent of the lot owners in the community. (See Guideline #1 and #2 above)

The Potato Patch Owners Association has submitted a copy of the February 6, 2002, Warranty Deed conveying the property of Potato Patch Water Services, Inc. to the Owners Association. (See Guideline #3 above)

The Owners Association has provided evidence that every member will have equal voting rights. Article III, Section 5 of the Owners Association's By-Laws provides "At all meetings of the Association each member shall be entitled to one vote for each lot owned." (See Guideline #4 above)

The community of Potato Patch is not within the service area of a municipal provider, it is certificated to Potato Patch Water Services, Inc. The Owners Association adopted a corporate resolution that limits water service to the lot owners within the four units of the Potato Patch community. The Owners Association has 90 current member/customers, and is limited to serving the existing 133 lots within the community. (See Guideline # 5 above)

The Protective Covenants of Potato Patch, section 18, provides that "None of the said lots shall be re-subdivided into smaller lots nor conveyed or encumbered in less than the original dimensions of such lots as shown by the plat of Potato Patch. Lot owners are able to purchase more than one property and consolidate that property for building code purposes. (See Guideline #6 above)

Membership in the Potato Patch Ownership Association is restricted to a fixed number of customers. The current membership is 90, with a total allowable limited to the available 133 lots. (See Guideline #7 above)

Summary

Potato Patch Ownership Association, D.B.A. Potato Patch Water Utility has properly filed for, and met the ACC's criteria for adjudication not a public service company. The Owners Association is a non-profit association, whose customers are its members. All members have equal voting rights. No municipal or private utility is seeking to serve the area, and the association will not be in competition with any provider. The Owners Association will only serve a small fixed area of 133 lots comprising the community of Potato Patch. Property owners are prohibited from any further subdivision of the existing lots.

The Ownership Association represents a united community organization. The Owners Association raised funds from its members to obtain and improve the water distribution assets, as well as arranging for a line of credit from Wells Fargo. A certified operator is retained to manage the water system. The Owners Association communicates with all members regarding water availability, the need to conserve and ongoing system repairs.

While this application represents the request of 90 current members, it is for part time customers. The community is recreational in nature, primarily summer cabins, requiring seasonal services. The ACC has granted other adjudication applications of 90 and 132 members. Therefore it would be consistent with existing public policy to grant the requested adjudication.

Authorized Rates

Subsequent to acquiring the assets the Owners Association approved increased rates and charges to the community as of April 18, 2002. The Owners Association is charging \$30 per month, with 2,000 gallons included in the minimum with additional 1,000 gallon increments priced at \$5.50. The ACC authorized rates for Potato Patch Water Service, Inc., are monthly charges of \$22.50, inclusive of 1,000 gallons of usage, and \$3.00 per additional 1,000 gallon increments.

The Owners Association revised rates without ACC authorization. The owners/members of Potato Patch have demonstrated a substantial financial commitment to the water system through the purchase. Agreeing to increased rates also demonstrates a community focused in part on ensuring its water needs are met. Staff recognizes that while the April 2002 rate increase was done to ensure adequate cash flows, it was without ACC authorization.

Staff recommends that until such time as the ACC authorizes new rates or approves the present Application for Adjudication Not a Public Service Company, the Owners Association bill the authorized rates of Potato Patch Water Service, Inc. Staff further recommends that the Owners Association inform the members of the unauthorized rate increase, and offer the affected members a refund of the differential between the paid rate and authorized rate.

Recommendations

Staff recommends that the Commission approve the transfer of assets from Potato Patch Water Service, Inc. to Potato Patch Owners Association.

Staff further recommends that the Commission order the Potato Patch Owners Association to inform its members of the unauthorized rate increase, and offer the affected members a refund of the differential between the rates paid rate and rates authorized.

Staff further recommends that the Commission grant the Potato Patch Owners Association, D.B.A. Potato Patch Community Water Utility request for adjudication not a public service corporation.

Staff further recommends that the Commission cancel the Certificate of Convenience and Necessity of Potato Patch Water Service, Inc.

XTNCO

RANGE 2 West

RANGE 1 West

W-1936

Potato Patch Water Service, Inc.

TOWNSHIP

12 1/2 North

